ALPHA DOGS:

Hunting for Alpha among Value Mutual Funds

By

Matthew Philip Baum

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Approved by:

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Dr. Chris Lamoureux
Department of Finance
Eller College of Management

STATEMENT BY AUTHOR

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Abstract

The Eller College of Management's Applied Investment Management class provides great exposure to class members of the demands of investment management. In addition, members have the opportunity to learn from experienced veterans in the field of finance through lectures given by Professor Don Seeley and outside professionals. One of the most informative presentations was given by Harry and Rose Papp who generously provided lessons that were directly applicable to the investment methodology of the class. Using the Papps as a starting point and next expanding upon an investor's desire to achieve above normal investment returns, analysis was conducted to determine what value, if any, investment managers add for their clients. Following this analysis there is a detailed account of each Applied Investment Management class period that helped to solidify the countless lessons learned throughout the 2008-2009 school year.

Introduction

The University of Arizona and specifically the Eller College of Management offer a great opportunity to students interested in finance and portfolio management. With a generous outside donation in 2000, the Applied Investment Management class was founded and hopes of benefitting both students and the University itself were created. A portfolio worth approximately $600,000 was allocated to one class of dedicated students to manage with the guidance of Professor Don Seeley. This donation, class, and portfolio were not intended to be an experiment of some kind, but rather a learning experience for students and a way to put the University's money to work. The decisions of the portfolio, including any purchases; sales; asset allocation decisions; and technical items such as stop-loss orders were to be entirely up to the students themselves. Although discretion and decisions were up to the students, structure and portfolio mandates were never lacking. With a set of guidelines including a target nominal return of 5.25% (4.00% for payout/scholarship needs and 1.25% for costs associated with the portfolio), the class was ready to begin work.

Nearly nine years later, in 2009, it is apparent that the initial donation was not meant to fund an experiment regarding the portfolio management capabilities of University of Arizona students. At this time, the Applied Investment Management class is the second longest running investment manager for the UA Foundation, the organization assigned with the task of allocating the University's endowment resources. And even through a tough economical situation, the 2008-2009 class has achieved quite astounding returns for the portfolio. For the month ending 2/28/2009 for instance, the portfolio experienced a negative 6.77% return while our benchmark or portfolio ruler returned a negative 7.57%. In each the one month, three month, year to date, one year, three year, five year and inception to date time intervals, the portfolio has outperformed the benchmark mandated in our investment policy. The one year figure may be the most relevant to our particular class of students and here the portfolio achieved a negative 22.20% return in comparison to a negative 31.86% for the benchmark. This spread of over 950 basis points, or 9.5% above the mandated benchmark is unheard of in the investment industry. If only it were positive.

The class itself is comprised of twenty undergraduate and ten graduate students (MBAs, Masters of Finance, and Masters of Accounting) and meets once a week for three hours to manage the portfolio and more importantly to gain experience. Class time is divided among high-profile speakers, lectures by Professor Seeley, and presentations by various students and teams. Each of the three components is necessary for the livelihood of the portfolio and all are discussed in the Daily Journal section. As for the speakers themselves, nearly all were inspiring and beneficial to our progression as investment managers. Two of the many great speakers that had a large influence on the thoughts of the class were Harry and Rose Papp.

Speaker Analysis: Harry and Rose Papp

Throughout their presentation on October 3, 2008, Harry and Rose Papp appeared cautious yet extremely confident in their abilities as money managers. They also exhibited immense understanding in both the financial markets and how the political sector influences these markets. Through their in-depth research and extensive backgrounds, they can afford to have such confidence in a disastrous time for the world economy. Their messages were brief, yet powerful, and again their level of confidence in their decisions appeared unmatched and unearthly in relation to other managers at this time. A large portion of the presentation was spent relaying their understanding of the current economic state, but indeed there were structural messages for our class to take away as well.

The Papps and their company, L. Roy Papp & Associates, are heavily focused on in-house research which is performed with a growth investment philosophy in mind. Their firm's impressive backgrounds, ten total partners who hold nine MBAs and seven CFA Charters, were more than a hint to those of us in the audience of the dedication needed in this business. Their experience and education was evident in the way that they talked and seemed to understand the complicated mess that is the US and world economy at this time. As they began to talk about their business and investment process, I couldn't help but notice the fact that it seemed fairly rational and simple. Avoid heavily leveraged (high debt) companies. Somewhat obvious. Look for consistent earnings growth and market leaders. No secret. Their list of processes continues from here, but none of which is more technical or mysterious than the previous. At times the Papps themselves seemed unexcited and unemotional about the business in general and this appeared to be a strength of the company. With emotions aside, the Papps can rid themselves of market fads and avoid falling into the trap of owning a trendy company with no history or apparent direction. Their unwavering and simple ideals are a testament to the solid education of this group of investment professionals.

The uncompromising approach that they incorporate when finding attractive companies extends into the buy and sell decisions that they face when managing their portfolios as well. In contrast to the fast-paced and sporadic investment decisions plastered in magazines and across television, the Papps buy and sell philosophy is purely mechanical. When deciding whether to purchase a particular security or company, a thorough analysis is followed by discussions with management, customers, vendors and even competitors. Next, if the company in question meets their strict standards based on free cash flows and consistent earnings, and if the identified value of the company is 20% or greater than the current market valuation, the Papps will make a purchase. Now, of course, the research process of our class is conducted in a much shorter and abbreviated format however there are important lessons to learn here. In addition to the financial analysis itself, it is wise to have some other basis for the recommendation through being a customer or employee ourselves or knowing a bit about the management. Also, the key that sometimes escapes those first setting foot into analysis is that a company can have excellent prospects, but the valuation must also be attractive in order to purchase.

As new research is conducted both in our class and at the Papp's firm, it is necessary to constantly evaluate the position and outlook of the current holdings. Not only are purchase decisions essential to the firm, there are those critical decisions to sell current positions as well. Throughout my college coursework the purchase aspect was emphasized to such an extent that decisions to sell never entered the picture. With the Papps on the other hand, their process is again mechanical. Their warning signals for a possible sell recommendation are, if there was a (n): error in the analysis, change in the company or industry, increase in the stock price to 50% above valuation, or need to diversify. Cleary there is discretion among any of these signals to sell, but it acts as a great starting place for the analysts at L. Roy Papp & Associates. Furthermore, this outlined approach to both buying and selling should be a very attractive attribute to potential investors.

For our portfolio specifically, it is essential to remember that the selling aspect is just as important as the decision to buy, for this is where profit is achieved. In class, the first mechanism that we use to evaluate our holdings is a team structure which is divided among the Standard and Poor's (or S&P) sectors. A team of four to five students focus their efforts entirely on two sectors, for instance Financial Services and Materials. Groups further divide new purchase and maintenance responsibilities among the students so that both of these essential areas are covered.

If for one reason or another a class member misses the clues to exit out of a current holding, our second line of defense is always there for protection. This stop-loss or automatic sale tool will help to limit our potential losses should any negative news be released about a company that leads to a sell-off of that particular stock in the market. By selling the position before the stock price drops further, this idea suggests, we will lose less in the event of a company catastrophe. There are many skeptics of the stop-loss mechanism in the investment industry, but for the particular environment in which we manage our portfolio it is a necessary item. Although the use of stop-loss has benefited our portfolio in numerous ways over the course of this year, it is not quite the same thing as selling off of an overvalued position. Currently, there is no standard for our class in the event that one of our holdings reaches an unreasonably high valuation. Due to the fact that our portfolio experiences new managers each year, it is potentially likely that a particular holding could slowly rise quite above a valuation that we would be comfortable with. That being said, it is critical to constantly monitor the portfolio. To do this, each of us should ask ourselves, would I feel comfortable buying into this investment position now if I did not already hold it?

I found it interesting to discover that the Papps were not shy to reveal which companies sparked their interest and which companies they hold in their client's portfolios. Of course outsiders could potentially profit off of the extensive Papp research, but how would they know when to sell? The Papps were extremely confident in their holdings and made us aware that now, more than ever, it was essential that a company had the necessary cash flow to operate. With the credit markets almost entirely frozen, only those companies with cash available may benefit from great opportunities such as in retail around the holidays. For Target, one of their top twenty holdings, this was indeed their thought process. With the combination of discounted merchandise, large market share, an established brand name, and cash flows; they feel Target is perfectly positioned to weather the current storm and achieve profits along the way. In addition to Target, Harry and Rose Papp had insight to provide in response to any of the questions thrown at them; a mark of a true professional and something that our class as a whole should strive for. We have the duty to understand our companies in a fashion that is matched only by those who continually analyze the company and industry.

In relation to the Papp's presentation, which greatly impressed our class, the next logical step was to see how effective their experience and strategy translate into investment returns. There are a number of ways in which investors evaluate particular investment managers, the most common may be strictly based on historical returns. For the average investor this may provide enough assurance on the surface, but this is not a complete or adequate way to decide where to invest one's money. Further analysis is needed to determine the suitability of the investment relating to a particular person's life situation as well as a look into the risk of the investment. Higher risk may often lead to higher returns, yet at the same time this strategy leaves an investor more vulnerable and susceptible to large declines in value. In effect, extra return may not be advantageous to an investor if it was achieved by simply assuming more risk in the particular portfolio. At the end of the day an investor is looking for alpha, or excess return, that cannot be explained in any way other than the value added by the particular manager.

Analysis of Investment Returns

The Capital Asset Pricing Model (CAPM) and relevant components are often the starting point for any analysis relating to equity investments. The equation suggests that the expected return of an investment can be explained by the risk-free rate (often the prevailing treasury rate) plus the market risk premium (MRP) multiplied by a coefficient (beta). The equation reads: $E(R_i) = R_f + \beta_i(E(R_m) - R_f)$. As seen, the MRP is comprised of two factors, the expected return on the market (say the universe of investments or the S&P 500 index) minus the risk-free rate. This figure is multiplied by beta, a coefficient that describes the volatility of the asset in relation to the overall market. A beta coefficient of one therefore will describe an asset that is perfectly correlated with the market and increases/decreases in lockstep with the market. A beta of two describes an asset that fluctuates twice as much as the market and a beta of 0.5 fluctuates half as much. In beta one finds risk. This entire factor, the MRP multiplied by beta, is then added to the risk-free rate, or the rate that one could achieve in a riskless asset, to determine the expected return of the asset/investment/equity. Without going into the history or discovery of the CAPM equation, it is widely accepted and used as a factor if not basis in analyzing particular investments.

So what happens when the CAPM equation suggests a particular return and the actual return figure is different? The basic CAPM equation incorporates an adjustment for this instance known as alpha. Alpha is inserted on the right-hand side of the equation and includes any unexplained benefit/cost that was not explained by the original equation, $E(R_i) = R_f + \beta_i(E(R_m) - R_f) + \alpha$. For investment managers and their current and prospective clients, a positive alpha is a very exciting thing to see. A consistent or statistically significant alpha suggests the investment manager is achieving excess return for their clients without assuming extra risk that can be explained by beta. Indeed there is almost never a 'free-lunch' in investments, but in the event of a positive alpha this may be the case. Before taking a look at the success of particular managers there is yet another addition to the CAPM equation.

The Fama-French Model expands the CAPM equation to incorporate other effects that some suggest affect the expected return of an asset. In addition to the MRP adjusted by beta, the Fama-French Model includes two other factors, small minus big (SMB) and high minus low (HML). The thought process follows that in addition to the market itself, a firm's size described by market capitalization is a factor in the return of any asset. Small minus big is a value that describes the actual returns of small firms minus big firms calculated by the team of Eugene Fama and Kenneth French. Historically, small cap firms have been able to achieve greater returns than those described as large or big cap. The second factor is high minus low, a reference to the book-to-market ratio of a particular firm. If a company has a high book-to-market ratio, it suggests that firm is valued in the market close to the value of the firm calculated by adding up all of the actual assets. A low book-to-market value suggests that investors anticipate large growth for the firm in question and are basing valuations off future returns and expansion. The Fama-French three factor model reads,

$E(R_i) = \alpha + R_f + \beta_i(E(R_m) - R_f) + s_i E(SMB) + h_i E(HML)$. The SMB and HML figures specifically are calculated in different time intervals, for instance monthly or quarterly, by the Fama-French team to be used to help analyze an investment. The two coefficients in front of these factors are specific to the investment and represent the amount of influence that these factors have on the hypothesized returns. All in all, the Fama-French theory is another respected model that many use to determine what is exactly contributing to the returns achieved by a particular investment. Again, alpha is present in the above equation and incorporates any returns not explained by the three factors (Bodie, Kane, and Marcus 435).

To put this hypothesis into practice it is necessary to look at returns over a relatively long period of time with several different managers. In this case, the goal was to look at the monthly returns for ten different mutual funds with a time period of twenty years, or 240 observations each. A value-orientated screen was used to search for mutual funds which attempted to locate those comprised mainly of high book-to-market firms. As one will see, the screen was mostly effective and those funds that were included without a value-based investment approach only added to the lesson the results provided. In addition to a Papp client portfolio courtesy of Harry Papp, the screen produced nine funds. The ten total funds analyzed were:

1. Ariel Fund (ARGFX)
2. Gabelli Asset AAA (GABAX)
3. Sequoia (SEQUX)
4. Eaton Vance Large Cap Value A (EHSTX)
5. Copley (COPLX)
6. Dodge & Cox Stock (DODGX)
7. Comstock Capital Value A (DRCVX)
8. Fidelity Advisor Small Cap Value I (FCVIX)
9. Weingarten Equity Fund (WEINX) - 218 monthly observations only
10. Papp Client Portfolio - 16 quarterly returns, 12/2004-12/2008

For funds one through nine, monthly returns were compiled beginning January 1988 and ending December 2008 (with the exception of WEINX which closed February 2006). In order to analyze the data, Microsoft Excel was used and in particular the Regression function. This function provided statistics relating to the investment's intercept (in this case alpha), the coefficient levels for MRP, SMB, and HML, and whether these results were statistically significant. By looking at these funds and the resulting statistics, inferences can be made regarding the prevalence of alpha (or lack there of) on an individual and group basis.

In order to locate the monthly returns on these specific funds, the Center for Research in Security Prices (CRSP) database was used. Using this same database, the Fama-French factors were also compiled, more specifically the relevant MRP, SMB, and HML figures for the time periods in question. Using the Regression function in Excel that incorporates the mutual fund's returns and the three factors, the regression intercept and various coefficients were found.

Using a 5% level of significance, or a 95% confidence interval, the regression was conducted. The main components of interest are the intercept values (the manager's achieved alpha) and the corresponding p-value. If the intercept were zero, this would suggest that the Fama-French model included all fund return information and the manager added no value outside that already incorporated in the individual assets. In order for the test to be statistically significant in relation to the intercept, the p-value shown must be less than 0.05, the 5% level of significance. In any case where the p-value is indeed less than 0.05, the result suggests there is sufficient evidence to reject the hypothesis that the intercept or alpha value for that particular manager is zero. In this instance, alpha was achieved. An overview of the regression results pertaining to each fund is displayed below.

Fund	Intercept	P-Value	MRP	SMB	HML
ARGFX	0.003425	0.051673	0.837891	0.247135	0.519221
GABAX	0.004861	9.13E-09	0.866494	0.102091	0.27459
EHSTX	0.003534	0.000463	0.891186	-0.21165	0.287841
SEQUX	0.00584	0.000861	0.772473	-0.32024	0.314913
COPLX	0.001563	0.34528	0.606444	-0.1349	0.513121
DODGX	0.003746	0.00024	0.98983	-0.04568	0.493431
DRCVX	0.002265	0.28761	-0.75618	0.036563	0.128946
FCVIX	0.003482	0.000501	0.807425	0.015378	0.087532
WEINX	0.003186	0.006234	1.020788	0.022813	-0.40565
PAPP	1.591029	0.040317	1.011589	-0.15322	0.079253

In summary, of the ten funds analyzed, seven demonstrated a statistically significant outcome at a 5% level of significance. This suggests that these managers did indeed achieve alpha, or excess returns for their clients. The three funds that did not exhibit a statistically significant intercept were: ARGFX, COPLX, and DRCVX. Not including the Papp portfolio, the six funds exhibiting significant alphas averaged an intercept value of 0.0041, or more appropriately, 0.4% in excess return per month. Annualized, this average suggests that the six corresponding managers achieved nearly 5% in excess return per year. Indeed there does appear to be a ‘free lunch’ for clients of six of the ten funds analyzed according to the Fama-French three factor model. Although the numbers themselves do not lie, there are effects of a Survivorship Bias present in the results. According to this theory, only strong mutual funds remain in business for many years and therefore their results can be inflated. Furthermore, these strong mutual funds that have lasted twenty years or more are more likely to have a benefit to investors, in this case alpha. It is strongly likely that the results of a pool of ten mutual funds picked in 1988 would underperform the results of these ten funds selected in 2009 in hindsight.

A quick look at the MRP coefficient figures can also help to provide information on the individual mutual funds. The coefficient in this situation is beta, which suggests how closely the mutual fund follows the investment universe (or S&P 500). A beta of one fluctuates in lockstep with the investment universe, while a beta of 0.5 fluctuates half of that. As one can see, most of the beta coefficients are relatively close, yet slightly under, a value of one. The DRCVX fund, which exhibits a negative beta is a fund which holds numerous 'short' positions in which the manager thinks a particular holding will decline in the future. By engaging in short positions, the manager can achieve positive returns when particular investment positions decline in value and therefore a positive (negative) return can be achieved when the market itself is down (up). The two funds that most closely track the market are DODGX and WEINX. For the average investor it may be appropriate to view beta as the level of risk, for a higher beta could potentially lead to higher returns, or in some cases greater losses, than the overall market.

The SMB coefficients, on the other hand, do not appear to follow any particular pattern. When thinking of this particular coefficient, the fact that the value is positive or negative is of most importance. Remember that there is both a SMB coefficient which is described above and the SMB factor which is calculated by the Fama-French team. When this coefficient is positive, the fund is orientated towards small stocks and therefore will increase in value during periods where small stocks outperform large stocks (when the Fama-French calculated SMB factor is positive). If the coefficient is negative, this is a signal that the fund will perform well when large stocks do well, or when the SMB factor is negative.

Again the coefficient's sign, whether positive or negative, is relevant when analyzing the HML values. Nine of the ten funds exhibited positive HML coefficients, suggesting a portfolio focusing on value over growth. When value positions, those with a high book-to-market value, outperform growth positions, these nine funds should theoretically increase in value. WEINX is the only fund that exhibited a negative HML coefficient and therefore invests with a growth focus in mind.

The MRP, SMB, and HML coefficients in general are informative, yet do not unequivocally suggest one fund as more attractive than the rest. An investor's situation must also be factored in as this has a great impact on the amount of risk that one is willing to assume.

Due to the smaller sample size and time period in which the returns were calculated, it is more difficult to make a solid inference about the Papp's results. Indeed these sixteen monthly returns cover one of the most tumultuous periods in market history and therefore the results are likely skewed. What is important to note is that the p-value is statistically significant which suggests that the Papps do achieve excess returns (or did so on this particular portfolio). The intercept value is of little use because the result that it portrays is unsustainable over long periods of time and is likely the result of such a short testing period. The Papps would be hard pressed to add excess return of 1,908% each year. The MRP coefficient for this portfolio is very close to, but slightly over one. This comes as no surprise as the Papps like to purchase established companies, which tend to follow the market closely. This is also in line with a negative SMB coefficient which again suggests a large cap or big stock focus. Finally, a positive HML coefficient is consistent with a value orientated approach where specific stocks are located that have a rather high book-to-market value. In comparison to the other eight value orientated funds however; the Papps are the closest to neutral, or zero, regarding this coefficient.

Analysis Conclusion

In this analysis it is clear that there are some mutual funds which exhibit unexplained excess returns according to the Fama-French three factor model. This excess return, or alpha, is something of great value that should interest investors as they attempt to select an investment vehicle for any of their needs. If a winner must be declared for providing the most excess return, it may come as no surprise to seasoned investment professionals that the famous Sequoia fund (SEQUX) provided the largest intercept or alpha value. On an annualized basis the data suggests SEQUX provided excess returns of 7%. In today's market climate that 7% alone would more than satisfy many investors. It is important to note, as always with investment products, that although these historical figures may accurately portray each fund's accomplishments in the past, the future results are entirely unknown. With more analysis, often more questions arise and this is a similar case. Investing is both an art and a science and a manager with the perfect combination of the two is extremely hard to find. Although there may always be more to learn about a particular investment, the Fama-French three factor model provides a much greater explanation about historical returns and what contributes to them then mere return information could ever do.

Daily Journals

The purpose of this journal is to recount the daily lessons of FIN 498H along with personal commentary in an attempt to develop my understanding of financial theory and the markets today.

9/19/08

Today's class was very important in that we had our first opportunity to hear from our one client, The University of Arizona Foundation. One of my first thoughts about the UA Foundation was that it seemed to be overly clustered. Although the task of managing over $400 M is no small task, even professor Seeley seemed to suggest that the use of a large number of managers could be counterproductive. Mr. Barker said that the University's assets were spread over 60 investments and nearly 40 different managers. My reaction to this is that there would be money lost over management fees and time spent evaluating this large number of managers that continuously reduces the return that the UA Foundation is seeing. As a whole, I expected the Investment Committee to select the investments however it appears that they focus on setting the allocation among different investment areas and then seeking out a respectable manager in that field. In addition to the numerous Investment Committee members and the managers themselves, there is a consultant for the UA Foundation who also seeks out worthy investments.

In regards to the portfolio that our class holds, this was created in the fall of 2000 with $622,483. An interesting thought to note that pertains to the previous paragraph; Mr. Barker mentioned that our class was the manager with either the longest or second longest tenure among all managers reporting to the UA Foundation. Again, this was something that signaled to me that there is a considerable amount of time spent reviewing the managers themselves that could be put to better use. Another note about our relationship with the UA Foundation is that we are considered managers in that we are paid like every other manager (1% fee) and our results our included in the results of the UA Foundation as a whole.

Our annual goal for the portfolio is a minimum of 5.25%, enough to maintain the principal after annual payouts and costs associated with running the portfolio. There are relatively few guidelines that the class needs to adhere to and it seems appropriate and again like an actual client-manager relationship in that we have a certain degree of discretion. Guidelines include: a maximum of 10% in an S&P Industry, a maximum of 5% in any one security at time of purchase, a maximum of 10% in a security due to appreciation and prohibited investments including foreign securities, interests in oil, active real estate, bonds below Ba rating, and others. A note about the prohibited investments is that the class can, after approval from the UA Foundation, invest in some of the investments currently prohibited. I would like to see this happen should any investments in these categories appear especially attractive. As a note, foreign securities can be purchased through ADRs and other means.

With our guidelines set, our class is up and running. Knowing the portfolio minimum goal (5.25%) and our current benchmark (70% S&P/30% Lehman Agg. Bond Index), it is possible for our class to begin the next nine months of management.

Briefly on one of the holdings of my group, which includes the Consumer Staple and Consumer Discretionary sectors, CVS Corp. is currently talking with Longs Drug Stores in an attempt to purchase the company. Although Walgreens is the largest drugstore chain of its kind in the country and is attempting to purchase Longs as well, Longs seems to prefer CVS at this point.

This is due to antitrust issues that have come up when Walgreens had proposed an offer, which was actually a larger per share offer than that of CVS. As professor Seeley noted, which is extremely relevant but was suggested outside of the takeover controversy, our group needs to consider which appears more attractive, CVS or Walgreens, as these are very similar operations. With an investment horizon of 12-18 months it is crucial that we make a decision considering the possibilities of the takeover and the effects on our portfolio and current holding of 650 shares of CVS.

9/26/08

To follow up on CVS Corp., the holding has been stopped out at this point and as mentioned previously our task in making the decision to repurchase or not is whether CVS or Walgreens seems more attractive. Our group will need to take the following into consideration when evaluating our next course of action related to this holding: the Portfolio Committee's (graduate students in FIN 423) decision to follow a value based approach, knowing the time horizon of 12-18 months for returns and watching the actions of Walgreens and CVS in respect to Longs.

The portfolio itself has been in our hands for nearly a month now and the market value has fell from \$860,259 to \$829,272 from August 28th to September 25th. The initial start-up process has been relatively slow moving as a result of one class per week and the Portfolio Committee's difficult task of developing and proposing our strategy and outlook for the year. Today, the Committee gave a brief breakdown of there initial outlook on the economy constructed based on industry estimates of the future value of the S&P with probabilities included based on the sentiment of the Committee. I suggested in class that the process of economic outlook should also include thoughts on current topics and the environment as well somewhat outside of the numerical calculation. I understood the basis that their thoughts on the environment were included in estimating probabilities for where the S&P could end up in one year, but I do not think this is sufficient. The comment was accepted by the representative of the Committee and it appeared that the class of undergraduates felt the same way. The outlook must be more than a single number that is spit out after using probabilities attached to S&P estimates. Professor Seeley acknowledged the concern and asked what I would suggest. At that point and even now I do not have a concrete recommendation on how to approach our market outlook sufficiently and am interested to hear what the Committee submits as their final outlook next Friday. It would be beneficial in my view to have a class discussion regarding what should be included in this outlook and the things that should not weigh on our decision so heavily (such as, in my view, the probabilities themselves when a non-numerical analysis of the economy seems more beneficial). I am also having a hard time understanding the class suggestion of seeking investments that are trading below their intrinsic value (the value approach to investing), when our outlook timeframe is 12-18 months. Although the time frame is understandable given the circumstances of this class, it does not seem logical that at that point an investment held in the theory of value would produce to the full potential. It is hard to find a solution to this because I do believe in the value approach of investing, yet understand we have only 9-12 months to hold the portfolio before another class takes over and changes or does not change the philosophy. This is something that I have been thinking about and continue to search for an answer or clear thought about.

Today Creston King of Davis Funds talked about his role in the management of one of their money market funds. It was noted in his presentation and I had read previously, that at one point people were so skeptical and frightened of potential portfolio losses that they were willing to accept zero return for US Treasury Bills (T-bills). Money market funds have also been in the news recently with the announcement that there have been some where the value of the fund per $1 invested was actually below $1. Something that money market funds are specifically designed to avoid. My initial reaction is that I am somewhat confused why anyone would purchase an investment knowing they are receiving only the amount that they put in (actually losing money if inflation is taken into account). Are there not savings accounts at banks or even online banks that are guaranteeing returns larger than this? For example, 3.00% APY from ING. Wouldn't another solution be a TIPS investment?

10/3/08

Today's guest speakers were Harry and Rose Papp of L. Roy Papp & Associates and they came to talk about their investment style and thoughts on the US economy. Both have nearly thirty years of experience and seem to be enduring the current economic state relatively well.

One particular moment that stood out was Harry's comments on Treasury Secretary Paulson and our other leaders so often in the news. Harry began by saying that it was against the law to yell 'fire' in a movie theater at any moment unless there was actually a fire. He related this to our current state and how there has been such large withdraws, especially from money market funds. He was visibly unimpressed by the actions of our leaders and it was the first time that I had taken a step back to evaluate those actions. What Harry had in mind as a different course of events I am unsure, but it was very interesting and valuable to be reminded to look at each news story in a way that evaluates each and every company/person/action etc.

Another interesting area that the Papp's talked about was when their firm decides to sell a security. I find that there are so many pieces of literature describing what types of securities or even which specific securities are good investments, but little information on when to sell. Their general rules for selling are, when a change in company or industry occurs, if the security is 50% overpriced, to diversify, and in the event of an error. The 50% overpriced rule is most interesting to me as this is the first time that I have heard a specific valuation at which a company would like to sell-off a position. I think it is just as important to analyze current positions as it is to search for new investments. For example, Hansen Natural Corp. (HANS) of which we have in our portfolio; over the past several years there has been both a dramatic increase in stock price and a large decline as well. In order to reap the greatest possible return it is necessary to acknowledge when the investment becomes too overvalued.

A question that I asked later in the presentation had to do with one of their top twenty client holdings, Target Corp. As Harry mentioned, he predicted difficult economic conditions to last well into 2009. I was wondering how he expected Target to perform in the next year given the state of the economy. I personally feel that tough times will lead the consumer to Target and Wal-Mart in order to seek deals, however these companies are largely impacted by margin and increased component costs could greatly affect their bottom lines. Harry suggested that Target would be fine and actually a surprising performer for the 2008 holiday season because of their low prices and more importantly, great ability to finance inventories for the fall. I now wonder what would lead bargain-hunters to Target over Wal-Mart?

Today the Portfolio Committee of graduate students suggested a lower target of total equities in our portfolio in anticipation of a weak economy for the remainder of the time we hold the portfolio. Our targeted amount fell considerably below the 70%/30% benchmark that currently evaluates our progress. A number of the undergraduates, including myself, felt that this was unwise in that should the stocks see a dramatic jump after months of lowering trends we would miss out on the profits. With such a low suggested target (55%), it would be nearly impossible to reach our payout objective of 5.25%. Currently, we voted to make efficient progress towards raising our equities to 55% of the portfolio and reevaluating at that point. Something the entire class seemed to favor. The surprising suggestion lead the Honors Thesis team to evaluate and suggest improvement for communication within the class, especially between graduates and undergrads.

10/10/08

Today the class has fallen somewhat into a disaster recovery mode. Many of our equity holdings have stopped out (been sold) as a result of the horrific week of selling on Wall Street. Most of the major indices are now down around 35% for the year and our equity positions now account for less than 20% of the portfolio. Compared to a benchmark that is composed of 70%, we are greatly underweighted. For the past few weeks an underweight position in equities greatly favored our portfolio as we did not have to absorb such substantial losses in comparison with a 100% equity or even 70% equity portfolio. As Dr. Seeley mentioned however, we are not being paid to hold our investment in cash or even make the decision between cash and equity so much as we are responsible for executing investment decisions based on our unique knowledge. Our guest speakers were even cancelled for the day so that we were able to focus entirely on the health of our portfolio.

My team is responsible for both the Consumer Discretionary and Consumer Staple sector and our holdings have dropped from five positions to only two as of today (one of which is a place-holder Exchange Traded Fund that should be replaced once a specific investment is found). Our only true equity position in these sectors is Hansen Natural Corp., a soft drink and energy drink company.

We spent class listening to the remainder of the preliminary recommendations in which each group presents on their current holdings. No votes are normally made at this point, but one specific group had such a well-organized presentation on an oil drilling company, Transocean, that we voted to purchase. As a class we also suggested which of the stopped-out holdings we would like to repurchase. Our group made sure to repurchase a smaller position in giant Proctor and Gamble and also a Consumer Staple ETF.

What happened this week? Why were equities battered so badly throughout the course of the week? As discussed in class, which I agree completely, is that fear is driving these enormous downward swings. Of course the majority of companies have outlooks that do not stack up with 2007 sales or previous forecasts, but the entire economy is affected. Business cycles are a regular phenomenon and there seems no logical reason to me that a company can be valued at a 35% discount to what they were nine months ago if something drastic in the company has not changed. In some companies this has, in a number of companies however their business activities are normal and various outlooks seem to be fairly positive relative to the circumstances. It seems like a great time to begin to raise our equity positions with sound investments found through conscious research. Although there is no defined bottom until well after the fact, I feel that it pays not to miss the great days that follow an economic disaster like the one we are currently facing.

10/17/08

The class has finally seemed to enter the regular course of business with two recommendations today, Praxair and Exxon Mobil. We also made a conscious decision to switch out of an iShares 1-3 year treasury product and into an iShares 3-7 year treasury product. This was a fairly short presentation and recommendation and it seems almost without a thought that we should be in the 3-7 year product in order to realize a somewhat decent return. Demand for such short periods like 1-3 years is so high that it has effectively squeezed out any real return and in some instances even preservation of capital.

As for Exxon Mobil, I was skeptical at first when it was presented, but the presentation and my own thought process lead me to believe that it was a smart and sound choice. After all, it seems to me that the class itself can have a unique or at least thoughtful opinion of such a large company despite all the research and media attention it receives elsewhere. With America's continued dedication to lower our dependence on foreign oil, we felt that either presidential candidate would more than likely promote more drilling off the shore of our Country in the near future. The market is obviously unfairly discounting strong and prominent companies and we felt this was an excellent time to take advantage. At the beginning of the presentation and for a large portion of it, I was very skeptical of the recommendation because Exxon does not spend any significant amount of time looking into energy sources of the future. Although I still feel that that aspect would have been a nice attribute, I realized through the presentation something that I had apparently forgotten; that each company we buy does not have to do everything, but merely focus on the market that it specializes in and commit itself to doing well in that area.

A portion of today's class was a lecture regarding the differences between organic revenue and revenue and where to locate these in a company's financials. Professor Seeley stressed the importance of paying attention to any Managers Discussion & Analysis (MD&A) section, which I feel is obviously essential.

Outside of class, our group has continued to follow various companies in our sectors and for myself that involves watching and thinking about Walgreens. Last week, longtime Walgreens employee and then current CEO resigned effective immediately only a few days after watching Longs Drugstores pull away from any acquisition attempt by his company. Currently we are favoring CVS among the two company comparison, but now we have to see what will happen with CVS and Longs Drugstores. A merger would definitely add to their market presence, yet could cause hiccups in the near term during integration.

10/24/08

Today we had an Eller Alum from Vanguard come to speak for a few minutes regarding opportunities and what their company is about. It is always nice to see the many things that Eller graduates are doing and that the school brand is getting out to all parts of the country.

Today's lecture focused on the differences between relative and absolute performance and included some information about the different forms of money market funds (MMF). As for money market funds, this is something that the class has not looked into and has frankly not even questioned in the days leading up to today's class. The Portfolio Committee will be looking into our current MMF and the different options that are available with Wells Fargo at their next meeting. Good idea I would say. Relative performance, to me, seems necessary in order to rate performance of a portfolio manager, but outside of that aspect it seems useless. It is not possible to eat off of relative performance even if you are performing 10% or 20% above year-to-date figures, so what is the use? Absolute performance (real returns) is what the investor cares about and what will help them achieve their financial goals into the future. That being said, obviously there are times that are harder than others and this is one of them. I guess I still feel it is relevant to achieve satisfactory relative performance when there is the appearance of little hope in the near future.

Outside of class again I have been mainly discussing Walgreens and CVS with another one of my group members. We seem to go back and forth on the two, but it is clear that Walgreens is going through a large personnel transition. With CVS, the acquisition news is significant, but we feel something that CVS could handle when the actual deal goes through. Now we are almost certain of our choice for CVS (strong growth, successful integration of Caremark a year earlier, and strong financials), but wanting to wait to see what happens following the likely acquisition of Longs Drugstores. Obviously managing a portfolio is a full-time job and along those lines it is sometimes frustrating to have the ability to make a recommendation only once each week. This component of the class is a necessary one however due to the time constraint and the need to fit our meetings into a university class period. I would add that, the fact that we touch the portfolio once a week and for a limited time can also be helpful in preventing hasty decisions.

As a class we are still late in catching up to our target allocation of 55% equities. As of today, we are roughly at 43.5% and still relatively slow with incoming recommendations. Each group is undoubtedly working diligently outside of class, but Professor Seeley has expressed that we need to be near our allocation if indeed that is where we thought we should be. It appears that there will be a flood of recommendations in the next several weeks as each group begins to sort out the ongoing debates like that for Walgreens or CVS.

10/31/08

Due to stop losses on both HSBC Corp. and China Life Insurance, our equities today only comprise 40% of the portfolio. Recent purchases appear to be performing relatively well for the short period that they have been in the portfolio (Proctor & Gamble 8.8%, Exxon Mobil 7.9%, and Microsoft 1.8%). Times are obviously volatile and these numbers will undoubtedly change in the next several weeks, but it is important that we attempt to locate companies that are able to endure today's very tough climate. I am impressed at the work that each of the groups is producing and the majority of the recommendations are well organized, planned, and presented. One thing that I have noticed is that the class seems to favor every presentation. There are always questions of course, but less than I would have imagined. It seems to me that some do not wish to ask questions or express a differing opinion and instead vote to pass each proposal. Obviously this is neither the entire class nor the majority, but it is surprising nonetheless. As mentioned in last week's journal, it is important that we achieve our benchmark weighting in securities soon, but it is also important that we keep this process a thoughtful one.

Thanks to the diligent work of the Portfolio Committee, we have approved a recommendation today to transition from our current government money market account to one that is able to invest in other areas such as high-grade corporate paper. The return that the two funds have achieved differ by over 100 basis points (1%) and for an almost guaranteed return, this difference is too great to pass up. This was another lesson for the class as a whole that there are many things about a portfolio to be watching and considering and there are sometimes hidden opportunities waiting to be discovered.

Today a final version of a Discounted Flow Analysis (DCF) was due. I have worked for several weeks on a DCF for Walgreens and it proved to be a great learning experience. First, there are almost endless things to consider when making future projections and forecasts and this is where an analyst's expertise can show. Second, a company's quarterly and year end statements provide a great deal of information and can often help to predict future financial results fairly accurately. Third, projections can be frustrating, yet dedicated work can help to uncover the direction of a company and industry. As for the results of Walgreens, my analysis showed that the share price was not particularly undervalued at the current moment. Although this fact was somewhat of a surprise, it was hard to miss the immense amount of money that Walgreens was using each year to expand. It also became evident that pharmacy and consumer staple sales have been hurt by the slowing economy. After listening to an earning conference call posted a few weeks back by management, I noticed that they wished to slow future new store growth. This slowing of growth may be unfavorable to investors today, but it enables the Company to focus on improving their core business before expanding too rapidly. All of these things and more impacted the past year's financial results and it still appears that Walgreens is attempting to find itself again.

The DCF of CVS proved more attractive and in many cases the growth rates projected were more conservative. After comparing the two, we realized that there was now even more reason to favor the purchase of CVS.

As a group, we now support the purchase of PriceSmart (PSMT), a membership warehouse retailer in the Caribbean and South America, and CVS. One of our group members stumbled on PriceSmart a few weeks ago and their management, sales figures, and competitive position seem very favorable. In today's class there was much talk about the number of recommendations that would be coming in the next several weeks and we hope to get at least one of these presentations in at the next class meeting.

11/7/08

Today another group member and I presented a recommendation for PriceSmart to the class. The class seemed interested and impressed by the discovery of this company and asked several clarifying questions before approving the purchase of 800 shares. Although I have not mentioned much about the work behind the recommendation of this company, we spent a large portion of the last several group meetings discussing the positives and negatives of investing in a membership warehouse retailer outside of the country in which we live. I am proud of the research our group has done to produce this recommendation and several class members expressed their excitement about this company. Although in my mind it is a strong addition to our portfolio, I immediately felt a sense of caution of falling in love with a company. The acceptance of PriceSmart by the class provided a nice sense of accomplishment, but also produced the concern that it is important to not become emotionally attached with one purchase or another. I have confidence in our recommendation, yet I remain interested to see how it will perform in the next several months.

Another recommendation that was approved today was for the purchase of Hudson City Bancorp, a regional bank in the northeast United States. Again, this was an instance in which I was unimpressed by the questions and concerns of the class. Although there were indeed questions, these came from the usual participants and when it came time to vote, the majority had no reservations passing a purchase of a bank that seemed anything but undervalued. This is not to say that this was an unwise recommendation or that I expect the price to flop in the next several months, but it is hard to watch a financial company get passed so easily. I had no problem not voting for this proposal as I thought it was necessary to take a closer look. This may or may not be a smart buy, but I did not have enough information and strongly feel the class was not prepared either. Sometimes I feel the class is too afraid to not approve a recommendation that one of our classmates has worked hard to prepare. There has been only one denial this semester.

Professor Seeley talked a bit today about the current state of our world and how this relates to our job in this class. He has just returned from a board meeting at Warnaco and relayed the news that the lack of consumer traffic in these times in unprecedented. For our class, this means it is necessary to not only produce sound recommendations, but to also constantly review our current holdings. The stop-loss mechanism is one that receives mixed reviews in the investment community, but one that Professor Seeley favors for use in this class. Although the state of our portfolio has greatly changed as the result of stop-loss sales in the summer and fall of this year, it has been important to force us to revisit our holdings on a frequent basis. As Professor Seeley mentioned, this mechanism forces us to ask ourselves whether we would purchase something now given current conditions/outlooks where we may have never questioned a current holding before.

11/14/08

The stock that we recommended last week, PriceSmart, has been slightly negative for the past week. The passing of our recommendation was satisfying, but it is now important to continue to watch our holding for any material change. One source of frustration that I am sure many people experience is that we located this opportunity and identified it as a good buy when it was several dollars cheaper than when we initially bought it.

Today two people from the Edward Jones fixed income desk and one from the equity desk came to speak about what they do and the world of finance today. Again, they reiterated the fact that these are unprecedented times and they have been experiencing the effects of the wild state of the market. As a whole, they mentioned, the fixed income market makes up about two times the size of the equity market, roughly 30 trillion to 15 trillion respectively. As I imagined, they have seen an unprecedented flocking to treasury securities in their client accounts as they try to achieve any level of security possible. They have seen many financial advisors looking to both the equity and fixed income desk for help and suggestions. It is interesting to think that a financial advisor, the person who manages money for individuals, does not know all about investments but it is impossible to do so. It would be impossible for them to maintain so much face time with clients, yet understand everything that the investment world entails. It is essential therefore, that there is substantial backing that provides information/advice to the advisor, such as a company like Edward Jones.

Our class as a whole seems to be more engaged and interested in what is going on especially with investment recommendations. Today we found out Hewlett Packard (HP) has been sold due to stop-loss and we have decided not to repurchase. Today we passed a recommendation for Research In Motion (RIMM), the makers of Blackberry. For an Information Technology sector company, I feel this is a great recommendation for such a difficult time. RIMM offers high-quality smart phones to both the business and private sectors. With the economy in such a tough situation it is hard to imagine the private sector will be strong, but that is fine with us. It was communicated that the business sector of the company is a more substantial part of the business, one with somewhat inelastic demand compared to individual private sector sales. In many cases the continued purchase of a Blackberry may even be a cost-cutting tactic of a company when deciding between that and personal computers for each employee.

Today we also learned that we will be presenting to the University of Arizona Investment Committee on December 5th to communicate the reasoning behind our portfolio. I am both excited and honored to have a chance to present in front of this group of people. Professor Seeley made it known that there would be a few presentations on recent purchases, one of which would be our recent recommendation of PriceSmart.

11/21/08

Today is one of the last normal class meetings of the semester. In the next two weeks we will have Thanksgiving break and the important Investment Committee meeting on December 5th. Unfortunately the wild times have continued and in the past week our recommendation of PriceSmart has gone from a popular buy to a forced sale due to stop-loss. Many holdings have been stopped out in the past week and the large majority of which we have decided to repurchase today. As we mentioned in our initial presentation, PriceSmart was susceptible to more volatility than some of our other purchases. The fairly small market cap, low trading volume, and low analyst coverage provides an environment where PriceSmart can experience large swings in either direction on any day. Although PriceSmart had fell below our $12.00 stop-loss point, we feel there is no material change in the company and that in the long-term, volatility may stay relatively the same with an overall rising trend.

As for CVS, our group has sufficiently debated over this company the entire semester. Financials look strong and the market for convenient pharmacies is not going anywhere especially with the large amount of Baby Boomers getting ready to retire. We still feel that there are too many hesitations for us to purchase, these include: the company's difficulty to expand in the future, increasing regulation and lower profit margins on drugs in the future, and slowing demand for the front-store sale items for everyday use. Also, we have spent a large portion of our time comparing CVS with Walgreens and we find it difficult to express a strong reasoning for one or the other. At this point the normal class periods for the semester have ended and we have no more time to make any decisions regarding these companies. Although we spent a great amount of time looking into these two companies, I feel we made the right decision given the information to not recommend one of these companies at this time. Hopefully we can sufficiently translate this information to the group covering Consumer Staples next semester so that they can continue to look into this as necessary.

PriceSmart will be the first recent purchase to be presented in our Investment Committee meeting in two weeks. As a class we are also closing in on our deadline to print the Investment Committee book covering our portfolio objectives, investment policy, holdings, market outlook, etc. We will also need to work together to streamline a presentation to communicate all of this information prior to our next class meeting.

11/28/08

Thanksgiving Break.

Our group has communicated over email to decide how the Consumer Staples and Consumer Discretionary sections of the portfolio will stand for winter break. In both sectors we are slightly underweight and have debated how to achieve our weighting when there will be no more recommendations this semester. Although nothing has been decided at this point, it seems that we will invest up to our weighting and spread these additional funds over our current holdings in each sector. This will include additional funds to our Staple and Discretionary ETFs for placeholder purposes until future recommendations are made.

12/5/08

Today we successfully navigated our first Investment Committee Meeting. I was greatly impressed with the work of my classmates and the quality of the presentation and portfolio book. Professor Seeley even congratulated our class for constructing one of the best presentations he has seen to the Investment Committee. All speakers were professional and knowledgeable in almost every circumstance. As for the PriceSmart presentation, the information and company itself was well received. Information on the company included up-to-date trading information and sales figures that only added to our credibility and initial thought process.

As for the repurchase of this holding, it turns out that we had bought it back almost at the same point of the stop-loss and therefore neither made nor lost any significant amount of money as a result. PriceSmart had been up 10% the day prior to our presentation.

The comments from the Investment Committee members, especially Chris Campisano, Harry Papp, Craig Barker and Dr. Lamoureux were one of the most important parts of the day. All of the questions/comments were well thought out and very relevant for the future of the portfolio. Some of the comments mentioned related to topics that our class has not even had a chance to look into; when this happened Professor Seeley made a point to mention that next semester we would be covering that information. Specific to PriceSmart, Mr. Campisano pointed out that all statistics and information should be given in context so that audience knows how to react. Was the double digit sales growth more or less than the company/analysts expected? One of the only points of confusion that I noticed related to a comment regarding negative convexity by Dr. Lamoureux as he questioned our bond fund that holds mortgage pass-throughs. I believe our class analyst was caught somewhat off guard and did not understand the comment that we may experience only slight upside potential compared to a greater decrease in price with this investment if yields move.

1/16/09

As the second and final semester of this class opens, I find myself analyzing two new sectors (Financials and Materials) with new group members. Although there may and should be communication with the new team that is covering my past sectors (Consumer Discretionary and Consumer Staples) I am looking forward to the challenge of analyzing financial companies in this difficult economic climate.

Within the two new sectors we have divided up the current holdings and I will be covering Morgan Stanley (a fairly recent purchase) along with another teammate. Out of all of the current holdings, Morgan Stanley appears the most volatile and it will be necessary to watch closely as the semester progresses. Other team holdings include: Hudson City Bancorp, Mack Cali REIT, OptionsExpress, and Praxair in the Materials sector.

In response to some comments by the Investment Committee last semester, the class is making an effort to focus on: our fixed income holdings relative to the benchmark, our thoughts regarding market conditions and what these mean, and that dividends can be subject to cuts. The fixed income portion of our portfolio, currently 35.9% of the total portfolio, is absolutely an area that needs attention. I completely understand the reasoning behind having fixed income, but there should be a coherent strategy attached with it. In addition, I could not even note the differences between our holdings and those of the benchmark, which in hindsight is extremely important.

The majority of today's class was spent reviewing the 2008 year and the many outrageous statistics that went along with it. One particular item that is very telling of the entire market is that out of the S&P 500 holdings, only 15 companies finished 2008 in positive territory. In addition, enormous point swings in regards to the Dow Jones Industrial Average seemed somewhat common and Treasuries produced double-digit returns. In continuing the portfolio's relative success to the benchmark, we produced a return of 4.52% in December compared with 1.86% for our benchmark. Year totals were (18.22%) for the portfolio and (26.03%) for the benchmark.

1/23/09

Today we had the great opportunity to hear from the Dean of the Eller College of Management Dr. Paul Portney. In connection with our prior suggestion to try and invest in socially conscious companies, Dean Portney was invited to provide some light on what exactly corporate social responsibility (CSR) entails. His definition suggests that a company follows CSR if they exhibit a consistent pattern of going beyond regulations in environmental protection and worker/product safety. The next, and most important part to our group, is how does this help a company (or stock price)? Dean Portney asked the class for suggestions and the list was quite impressive. The suggested benefits of CSR to a company were, it: attracts better workers, appeals to customers, prepares for future regulation changes, benefits from tax cuts, and benefits the community. And to the bottom line we ask? Dean Portney suggested that engaging in CSR may help improve net income figures however this is not guaranteed.

In continuing with the class concerns regarding the fixed income portion of the portfolio, a voluntary group will be formed and headed by Guillem, an MBA student. I plan to volunteer for this opportunity next week and I am eager to improve this somewhat struggling area in our portfolio.

1/30/09

Microsoft, a past holding, was stopped-out within the last week. I hope that we do not return to this holding this year as I believe it has performed poorly in our portfolio several times.

Today we had the honor to host Hal Lindquist, Senior Managing Director of The Blackstone Group. This was, hands down, one of the highest profile and best speakers of the entire school year. Although some of his material was difficult to understand and relate to, especially the statistical portion, the class was on the edge of their seats to hear Mr. Lindquist speak. One of the most amazing stories that he shared with the class was his prior experience with the now infamous Bernie Madoff. Sometime seven to eight years ago, Mr. Lindquist said, Madoff approached him searching for a large investment from The Blackstone Group. His returns were indeed impressive, which attracted many into Madoff's net. Mr. Lindquist next asked to see how and where the money was being used, an answer which Madoff could not provide. With no real explanation of the actual use of incoming funds, Mr. Lindquist passed on the opportunity. At the present this decision looks pretty good. The important lesson to be learned is to do your due diligence when investing and always to ask questions. A side note from Mr. Lindquist is that he strongly recommends the new Warren Buffett book *Snowball*.

2/6/09

The portfolio's new performance results have been released and once again we have outperformed the benchmark. For the one month ending 1/31, the portfolio achieved a negative 2.43% return compared to negative 6.16% for the benchmark. Three month performance is even more impressive as we achieved a negative 0.44% in comparison with negative 8.28% for the benchmark.

Today's lecture focused on the important area of fair value adjustment. For many items on a company's balance sheet, historical figures are used and are of little help to an analyst or investor. In order to combat this problem a hierarchy of fair value adjustments was created. This hierarchy is used to establish the reliability of the fair value figures as there could be large discrepancies on a similar asset depending on the type of valuation used. The most accurate and beneficial level for investors is Level 1, these fair values figures are found by using quoted prices on identical products in the market. Next, Level 2 figures describe any valuation that was achieved by using market information for similar, but not identical products. Lastly, and of least use to investors is Level 3. Here these figures were located through a variety of ways including forecasting results and through discounted cash flow analysis.

2/13/09

Today Starbucks was purchased by the class after a very well constructed presentation. Although the information was all present, I did not approve of the overall thought process and therefore did not vote in favor of this purchase. Starbucks, for me, is a difficult company to consider for a variety of reasons. On one hand, the Company can benefit from the dedicated customer base, a healthy brand image, and distribution channels in place. One the other, I feel that consumers preferences may have shifted away from such expensive luxuries and that large growth is impossible due to the enormous size of Starbucks at the present moment. Now that it is in the portfolio however I am excited to watch this holding and see how it does for us.

Outside of class, the fixed income team met with Professor Seeley to discuss how to begin looking at our current holdings. Firstly, and most importantly, it is necessary to understand the components of our benchmark as this is what we will be measured against now and in the future. Second, we must begin to understand our current fixed income positions and the various characteristics before we chose to sell something that we should actually keep for one reason or another. At this point, Seeley suggested, we need to establish a consensus view of the economy, fixed income markets, interest rates and yield curve. It sounds like we have a fair amount of work to complete at our next meeting. What is our view on treasuries? How much lower can yields possibly go?

2/20/09

Class recommendations seem to be slow to this point of the semester. For our group specifically it is easier to locate a company that we feel shows great value relative to current prices, but the hard part is deciding to go through with the recommendation as we continue to see the markets slowing. Today Techne Corporation (TECH) was presented and passed, a company that focuses mostly on hematology controls used in hospitals to check blood analysis treatments. Although there have been few presentations from the beginning of the semester, the class strongly feels that now is the time to fill our portfolio and rid it of placeholders such as sector SPDRs.

Today's lecture topic revolved around stock option and pension fund accounting, two areas of particular importance in recent years. In relation to stock option accounting, the major change in the last five years became effective 6/15/05 with the rule that option values must be recorded as an expense at the time they are granted. For companies who focus heavily on this form of compensation, there were definite changes and concerns from this date forward. For investors and the outside public, this new rule increased transparency of statements that made another area of concern easier to compare among different companies. An interesting piece provided by Professor Seeley showed the large discrepancy apparent between including and not including stock compensation expense. One particularly interesting item was 2008 operating income for Yahoo!, $0.42B before stock-based compensation expense and $0.01B after.

We had our second chance today to hear from Richard Mudinger, head of the CFA Society of Tucson. His sentiment was very pessimistic today as one would expect of someone who must continually answer to clients why their portfolios are heading down. He, like many speakers this year, pointed a finger at the government and media for increasing the fear among the public. Among some high notes for me and the Fixed Income team I have been working with, he mentioned numerous areas for opportunities that we are already considering for the portfolio.

Areas for opportunity that he mentioned were: inverse treasury, high yield, and corporate bond funds.

2/27/09

At this point, the fixed income team has agreed to explore individual corporate bond securities as a potential addition to help increase our corporate bond allocation to its increased target. In class today I presented the idea of searching our broker's inventory and possibly purchasing a security prior to next meeting should something be attractive. Per Professor Seeley, the fixed income team thought it would be right to have prior class approval of this idea should we indeed find something attractive as the broker's inventory is constantly changing. The class was skeptical to approval a general proposal although I did cover our various stipulations (BBB-A rated, short maturity < 10 years, non-callable/non-convertible, and preferably in the utility, healthcare, energy or staple sector). As a result of the uneasiness of the class, the fixed income team will still look at the broker's inventory next week to get a better idea of possible options and we will explore this idea further after that meeting.

In our Financial and Materials group, we have had numerous discussions revolving around the possibility of recommending Wells Fargo or JP Morgan Chase to the class. At this point we feel that these two banks are strong enough to survive the current turmoil and will return to prominence in the future. Personally, I have spent time looking into Wells Fargo and at this point believe this could be a great, yet volatile addition to the portfolio. After listening to the 2008 4th quarter earnings conference call there appeared to be numerous positive signs and area for opportunity going into the future. Several positive aspects included: lower deposit costs compared with competitors, increased penetration in accounts with credit cards, and many opportunities related to the Wachovia purchase.

In class, a member of my Financial Team presented the purchase recommendation of Visa, which passed. Although I did not have a large hand in this recommendation, our group had discussed this idea more than once and felt this was an exciting area to enter. With credit card usage up and continuing to increase we wanted to take advantage of this trend that shows no signs of slowing. Although there may be risks for banks/companies that assume the risk of payment by the consumer, Visa is somewhat immune to this as they receive compensation based on the number of transactions. Payments run between the banks and the consumers with little to no effect on Visa itself. With many turning to credit cards in these tough times, as well as the ease of credit card use in general, we feel this is a very strong addition to the portfolio.

3/6/09

During today's class I was in New York City participating in the FMA Finance Leaders Conference with three other FMA members. Much of the work for the fixed income team that I had been working on seemed to come together in the last several days prior to leaving for New York. After email correspondence with this group, I was able to stay updated with the progress described below.

Although the Fixed Income team was ready to recommend various changes to the portfolio today, time did not permit our group to present these changes. We have been working with our team of volunteer students and Professor Seeley the past several weeks to develop and implement a strategy that fits our outlook. This week several of our members met with Professor Seeley to talk with the class broker regarding potential individual corporate bond securities that may appear attractive. After this meeting it appears that there may be opportunities in individual corporate bond securities, but at this time the costs outweigh the benefits. With a new class holding the portfolio in half a year's time, there is the potential for great loss should they wish to sell in an environment with low demand for that particular offering. As of now we will continue to concentrate on finding a suitable corporate bond fund besides our current holding of LQD. Reasons for this include our desire to increase our corporate bond target allocation and our skepticism about future LQD performance.

3/13/09

Today we had the great opportunity to hear Steve Leuthold of the Leuthold Group speak. His firm is extremely respected for their research and recently for their funds as well. Although shorting does not seem to be the core business, it was amazing to hear that his Grizzly Short Fund returned 74% in 2008 and 26% in early 2009.

A large portion of his presentation time was spent analyzing graphs that he had constructed relating to the current market state. Several of his pieces of analysis focused on various market aspects that do not have a clear correlation with market movements, such as Consumer Confidence. His piece demonstrated that from the 1960's, Consumer Confidence has seen large swings in both directions and although some correspond with a rising market, there are plenty of data points that suggest the opposite.

Other charts suggested that some historical figures are indeed useful and those point towards a great buying opportunity in our current market. Several pieces focusing on P/E ratios demonstrated just how low valuations have become in recent times. On his chart mapping out Normalized P/E ratios from 1957 to date, current valuations of around 10.6x fall into the lowest 10^{th} or 11^{th} percentile. Needless to say, Mr. Leuthold feels stocks are cheap.

Continuing with the Fixed Income team that I have also been working with, we presented a number of recommendations today in order to implement our team strategy. Although it still appears that the class (as well as our group possibly), is unsure in which security to focus for our Corporate Bond allocation, the majority of the Fixed Income Team recommendations were fulfilled today. Changes to the portfolio included: selling the Emerging Markets holding EMB, selling a portion of our 3-7yr Treasury holding to reach our lower allocation, increasing our holding of TIPS, and purchasing the T. Rowe Price High Yield fund to achieve our new sector addition. As for corporate bonds we will continue to hold LQD until a reasonable alternative is found. A nice addition of the day was during Mr. Leuthold's presentation when he actually reaffirmed many of the Fixed Income Team's recommendation (which he had yet to hear), including advertising the T. Rowe Price High Yield Fund.

As for February 2009 performance, we have once again beaten our benchmark as has been the case for most of the school year. Our portfolio returned (6.77)% in February verse (7.57)% for the benchmark. Again, relative performance in my mind is not much unless you are in positive territory, but for an investment manager our continued achievement above the benchmark is a good sign. Hopefully with the new and improved fixed income portion of the portfolio, we will be able to achieve decent returns in this area as we produce a measly (2.16)% in February.

3/20/09

Spring Break

3/27/09

Today Panera Bread was recommended and passed in class. This fresh food sandwich and salad chain is believed to be weathering the economic downturn by attracting the health conscious. This was yet another addition to the portfolio that I did not feel confident enough in to vote. It is simply hard for me to believe that people are continuing to eat out, especially in a place that I am entirely unfamiliar with. This could be a winner, but I am not putting my money in Panera.

The speaker today was Ben Armstrong and although he was very interesting to listen to and learn from, the most effective thing that I picked up was his hypothesis on how investment managers should be rated. He argued that an investment manager's success can be looked at through two lenses, outcome and/or process. He argued that process itself is more essential than any outcome figure. Some may be lucky for a short period and achieve great outcomes; however over time the manager with the best process will perform the best. Process is what matters Mr. Armstrong suggested and I believe him.

Professor Seeley talked briefly about the interesting field of technical analysis today. Although I do not have much confidence in this hobby as a complete investment process, I do believe there are some theories worth looking into. For myself, it makes sense that after the necessary due diligence, one can look at technical analysis as a way to better decide when to enter into a position. I do not think it should be used to decide if one enters into a position in the first place however.

4/3/09

The speaker today was Brett Hammond, Chief Investment Strategist for TIAA-CREF. Mr. Hammond presented a day earlier in McClelland Hall's Berger Auditorium and gave the class a concentrated lecture surrounding a similar topic. His Company is researching a different way to allocate portfolios called Reverse Asset Allocation or Beta-Driven Investing. The concept is basically designing portfolios around alternative assets with healthy statistics followed by adding major sectors such as US Equity and Bonds. This is obviously the reverse of the industry norm and what he expressed as conceptually correct. There is no doubt that Mr. Hammond was one of the most high-profile speakers we have had this semester, but what does this all mean to me? Personally, I understand that there are many people searching for a way in which statistics can answer those difficult investing questions yet I simply do not agree. To his point, he did make it clear that this was a starting point for allocation in which smart investments would be needed to fill the allocation percentages. I still have a hard time understanding the use in spending such time plugging numbers into a system that spits out the optimal allocation percentage figures especially doing so in this way for the first time. I will stick with traditional research and personal market views for the time being. Of course there is the possibility that I completely missed the essence of his idea.

Today, Harshil and I finally presented Wells Fargo as a purchase recommendation to the class. We have debated, put on hold, ignored and watched Wells Fargo for over a month and I am happy to have presented and passed this position. In my mind, the financial sector has seen declines of unwarranted levels and Wells Fargo seems greatly positioned for the future. Personal concerns include government regulation, off balance sheet items, and mortgage and credit card payments issues. Frankly, all of the major banks are experiencing these items and I feel Wells Fargo is not only conservative, but viewed in a much healthier light than other major banks. How should a stop-loss level be set for this company? There are many unknowns that I recognize, but I still see great value in Wells Fargo. The investment community sentiment towards financials in general appears to be that undervaluation is rampant, but uncertainty and volatility are preventing many from making the purchase decision. Although I do not expect a long-term decline in this stock, I do recognize the great possibility for continued volatility and declines going forward. For me, this seems a great positive as our portfolio is not chasing next week's or next month's returns. With an investment horizon of 12-18 months, I do not feel such a great pressure to perform within a near time frame. I also know that I will be fired as a manager on May 1, when the semester is over, so I certainly do not fear recommending a company for purchase no matter how frightened other investors may be.

On another note, the class also purchased Life Technologies (LIFE) a company that is involved with DNA sequencing among other things. Again the issue of either uninformed or lazy decision making appeared apparent in the class. After a failed vote by one, there was further discussion of the positives and negatives and the recommendation passed on a second vote by three votes. Although I was not surprised to see this pass (I did vote for purchase both times), it is incredible to me that four people changed their votes after a few minutes of discussion. I believe this is a great addition to the portfolio, but I do not understand the thought process of some classmates. What was mentioned in two minutes of discussion that answered what you questioned about LIFE? And if there was some lack of understanding or doubt, why not ask the presenters to better explain themselves?

4/10/09

Wells Fargo has jumped in price nearly 30% since last week's recommendation. Although neither Harshil nor I have any timing expertise, it feels nice to be so quickly rewarded. The class does seem excited about the holding, especially because our new asset allocation calls for an overweighting to the financial services sector. Long-term I still feel confident that Wells Fargo (and its stock price) will continue to progress, however I also recognize that these short-term fluctuations are impossible to predict and possibly sustain.

Another recommendation from last week, Life Technologies, has yet to be purchased. Although it was indeed passed by class vote last week, the responsible analysts had failed to construct a Discounted Cash Flow (DCF) analysis for valuation purposes. Professor Seeley made it a point in class that the valuation aspect of any purchase is essential and without this necessary item, no purchase would be made in this class. The Wells Fargo presentation from last week also did not include a DCF analysis, but not because we wished not to complete one. As a result of this difficult economic time, it has become nearly impossible to forecast revenue figures for any financial services company due to the presence of one time items. These write-offs, impairments, loan losses, etc. are impossible to predict and therefore future expenses and costs are equally impossible to forecast. Government regulation, a bank's willingness to lend, and the consumers themselves are all huge factors in the future of, not only Wells Fargo, but any financial company. As a result, Wells Fargo was the exception to the rule regarding valuation analysis requirements.

Today the lecture covered Accounting Abuses and the many ways in which a company can mislead the public or investor. From big name scandals like Enron and Worldcom to the lesser known issues of Krispy Kreme and Qwest, it seems that any company is susceptible to stepping over the ethical line. Each account of corporate accounting abuse seems to differ slightly as CEOs, CFOs and managers search for any way possible to meet earnings expectations and investor demands. One thing that was striking to me was the nature in which most of these scandals occurred. Often a small ethical blunder followed by another created a snowball effect that was soon impossible to contain. For me, it makes most sense to never travel down the road to tarnishing my reputation for money in the first place.

4/17/09

Today a fellow group member and I presented the weekly Economic Review which recounts the events of the current week. It is starting to seem to me that the financial markets are preparing for a US economic revival although there has been little exceptional news to report of. For the past several months, investors and media outlets have been hanging on to any new piece of information, driving markets in the direction this news suggests. The issue I have with this is that one small event itself should not have such a large effect on the equity market or even a particular company. The daily swing of major indices of 1% or greater increments is just not practical or sustainable. It has been very important therefore, for our class to keep a more long-term focus than most by keeping sight of our decided 12 to 18 month investment horizon.

Today we continued to talk about accounting abuses and particularly how to recognize the possibility of these through financial statement analysis. It can be easy to take a company's financial statements as truth, especially in this period of GAAP and government regulations, but it is important to remain objective. The truth is that company management often has pressures which can easily lead to fraudulent activities. This will always continue to be the case when both money and the human element are involved. In order to discover fraudulent activities, Professor Seeley noted, it is prudent to pay particular attention to the Accounts Receivable (AR) line item. When a company records false revenue, the thought goes, an increase in AR occurs. If this was an actual sale, eventually the AR account would fall as the debt was repaid. In the case of fraud, the AR account continues to balloon out of control until the lie is no longer able to be covered up.

4/24/09

Last week, the Fixed Income team I have been a part of concluded their work for the semester by presenting one final time. With our various views on the economy and particular fixed income products, we decided to increase our allocation and holding in the T. Rowe Price High Yield fund (PRHYX). Today, the fixed income portion of the portfolio finally appears to be a completed work, a result of careful analysis. This is not to say that no attention should be paid to this area from this point forward, as this is far from the truth. Today, however, the fixed income team was able to see the final product of our semester of work and it is a very satisfying feeling.

At this point, each fixed income holding is in positive territory since purchase (for the first time this school year I believe). Hopefully now our fixed income portfolio can overcome our benchmark in monthly comparisons.

Today the class discussed the many issues related to corporate boards and how regulation is now affecting this area of business. Sarbanes Oxley (SOX) and other attention on this issue have helped to tighten standards that had previously allowed easily identifiable conflicts of interest. Corporate boards themselves are an interesting animal and have many interworking parts. Boards within the board of directors and sub-committee chairman now help to delegate responsibilities and provide a system of checks and balances. SOX is also very important for the business world and one of the most important results of this is that company executives must now sign off on the accuracy of financial statements.

5/1/09

Today was the bittersweet ending to an entire year of portfolio management. Our work culminated with a very polished presentation given to the Investment Committee which included: Hal Lindquist, Craig Barker, Chris Campisano, Harry Papp, Dr Chris Lamoureux and Dave Brady. Once again our group's performance was extremely impressive and all in attendance would (and did) agree. Except for a few minor points of confusion, especially on the fixed income portion of the presentation, the material was concise and easy to understand. One of the greatest comments of the day was by Hal Lindquist, of The Blackstone Group, who suggested to UA Foundation V.P. of Finance Craig Barker that he allocate additional funds to our group. This was quite the complement.

Professor Seeley helped to provide closure as we recounted the many items we had learned throughout the semester. Our experience, he said, was a great opportunity because we were actually emotionally attached to our project like all investors, yet we were not using our own money. The class spent twenty minutes listing the lessons learned throughout this experience, a sampling includes: bubbles exist, be aware of leverage, intermediaries caused trouble, rating agencies caused trouble and globally all nations are tied together.

As for next year's class I would like to suggest a couple of items. The first of which is to pay as much attention to the fixed income section as you do any of your sector assignments. This portion of the portfolio is substantial in size and you can learn an enormous amount from paying attention to our holdings. Second, the more you put into the class the more it will return to you. Thirdly, do not underestimate the experience of Professor Seeley and the various speakers. Fourthly, and most importantly, be curious and ask questions.

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